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C O N F I D E N T I A L SECTION 01 OF 05 MONTEVIDEO 000189

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SUBJECT: URUGUAY: SCENESETTER FOR SECRETARY RICE

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Classified By: Ambassador Frank E. Baxter
for reasons 1.4 (B) and (D)

¶1. (C) Summary and Introduction: American Embassy Montevideo and I warmly welcome your participation in President Bush's historic visit to Uruguay. Though led by a left-leaning government, Uruguay shares many of our values and remains an island of democratic stability and good governance in a turbulent region. The presidential visit sends a powerful signal to the region that we favor good relations with sensible, pragmatic governments which respect democracy, human rights, and the rule of law, regardless of political label. The visit is also an opportunity to advance our improving bilateral relationship beyond trade and to highlight U.S. policy priorities in the region: consolidating democracy, promoting prosperity, investing in people, and enhancing security. This is also a chance to listen to the Uruguayan perspective on challenges, problems and threats in the Western Hemisphere.

¶2. (C) The POTUS visit may help Uruguay resolve its philosophical quandary between economic dynamism and socialist egalitarianism. Many elements for strong economic growth are in place. The traditional pillars of its economy -- farming, tourism and finance -- are all doing well, and foreigners are increasingly investing here. But three things hold Uruguay back. The first is that Uruguay is part of Mercosur, which now includes Venezuela. Mercosur has increasingly devolved from an imperfect customs union into a more restrictive and anti-American political organization. Uruguay might need the consent of its Mercosur partners to negotiate an FTA with the United States. Second, the current Frente Amplio (FA) government still harbors hard-line Socialists, Communists, ex-guerrillas and powerful trade unionists. While in the minority, these groups are nevertheless quite vocal. Many ordinary Uruguayans seem content to leave large segments of their economy, including telecoms, power generation, oil imports and several banks, in state hands. The culture still values professions which are not particularly useful in the global economy. Still, an educated population, strong respect for the rule of law, and a good infrastructure make Uruguay one of the most attractive

destinations in the region for foreign investment.

13. (C) Uruguay punches above its weight in foreign affairs, but ideological divisions within the FA also explain its sometimes ambiguous foreign policy. For example, the anti-American Foreign Minister has been virtually absent from the substantive bilateral trade discussions with the U.S. He has also been a non-player in Uruguay's number one foreign policy concern: the long-running, serious dispute with Argentina over pulp mills. While the GOU does not agree with the U.S. on many international issues ranging from Kyoto to Cuba to the War in Iraq, both countries value freedom and independence. Uruguay's vibrant democracy highlights the fallacy of populist regimes such as those in Venezuela, Bolivia, Cuba and Ecuador -- and to a lesser extent Argentina. The Economist magazine recently rated Uruguay as the only country in South America to enjoy "full democracy." The GOU seeks more U.S. trade and investment, but is vulnerable on energy supplies and is very frightened about its dispute with Argentina. Uruguay also faces a long-term demographic problem: a low birth rate (except among the poor) is exacerbated by the brain drain of young people who are emigrating abroad in search of jobs. To the extent that we can, we need to re-assure the Uruguayans that we are their friends, increase our cultural exchanges and try to encourage them to cooperate more assertively on issues of regional stability and security -- including counter-terrorism, counter-narcotics and mil-to-mil cooperation. End Summary and Introduction.

Observations and Developments

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14. (C) The last POTUS to visit Uruguay was President George H. W. Bush on December 4, 1990, when then-mayor Tabare Vazquez presented him the keys to Montevideo. Most Uruguayans will be delighted at the recognition and prestige the visit offers, but some observers might conclude that this visit is designed to counter Hugo Chavez' growing influence in the region. We understand that Hugo Chavez plans to travel to Buenos Aires on March 9 to address a rally there, and that he is bound to fire his usual diatribes at President Bush, in a replay reminiscent of Mar del Plata. Close Uruguayan contacts recommend that we do not take Chavez' bait or respond to his remarks. Brazil's President Lula visited President Vazquez on February 26 in an attempt to rekindle Uruguay's interest in Mercosur. On March 1, President Vazquez will deliver his second State of the Union address.

Background

15. (U) Uruguay is a small, stable democratic nation of 3.3 million people, almost half of them residing in its capital, Montevideo. Once known as "the Switzerland of South America," it has long been one of Latin America's wealthiest and most egalitarian countries, with per capita GDP exceeding \$6,000 during periods of growth. However, a four-year recession, which ended in 2003, cut this figure nearly in half and lowered Uruguay's historically excellent socio-economic indicators. Uruguay's economy has been recovering well over the past three years, with GDP growth of 7 percent in 2006, in large part thanks to continued orthodox economic policies. GDP per capita is back to \$5,700, and the GOU recently repaid its entire IMF debt early. Some observers believe that Uruguay seeks to emulate Chile's economic model.

16. (C) Many Uruguayans were traumatized by the 1973-85 period of military dictatorship, when security forces committed serious human rights violations in the campaign against insurgents and their sympathizers. Some people blame the U.S. for indirectly supporting the region's military governments during the Cold War. Slick propaganda and declassified U.S.

documents from the period are frequently used by our detractors as "proof" of our involvement. The complex history of the dictatorship created heroes and villains for both the left and right. Some of the persons involved -- including former Tupamaro guerrillas -- are still active in politics. The real and imagined lessons from the period continue to influence modern politics, including Uruguayans' perceptions of the U.S., especially where the Global war on Terrorism, Iraq and Afghanistan are concerned.

Bilateral Relations: Key Issues

¶7. (C) Expanding the trade relationship has been the foundation of our engagement with the GOU. On May 4, President Tabare Vazquez met with President Bush in the Oval Office where both leaders agreed to deepen our trade relationship. After this meeting, a series of visits by USTR officials examined the possibility of FTA negotiations, but the discussions did not immediately bear fruit. Instead, DUSTR John Veroneau traveled to Uruguay to sign a Trade and Investment Framework Agreement (TIFA) on January 25, 2007. Aside from trade, we also need to intensify bilateral cooperation in areas such as counter-terrorism, counter-narcotics, mil-to-mil cooperation, container security, bio-fuels, the upgrade of Uruguay's civil aviation authority to Category 1, alternative sources of energy (especially wind, bio-diesel and ethanol), phytosanitary issues, science and technology, English language teaching, and cultural exchanges.

Uruguay's President

¶8. (C) A practicing physician, President Vazquez is a cautious and prudent man who is sometimes shy in

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international settings. We believe he proposed meetings at the Anchorena ranch, in part because of this personal preference. He appears to style himself after Chile's ex-President Ricardo Lagos, and his mild leadership style sharply contrasts with the populism of Venezuela's Hugo Chavez, Argentina's Nestor Kirchner and Bolivia's Evo Morales. While he is sometimes hesitant to utter the words "Free Trade Agreement" in public, Vazquez and his administration have repeatedly stressed their eagerness to maximize trade with the U.S. In private, they have made it clear that their objective is to negotiate an FTA with the U.S.

¶9. (C) Vazquez is a pragmatist, and what he most wants for Uruguay is jobs, investment and growth. At home and abroad he has been caught between the competing demands of radicals and moderates, and he often faces a tremendous challenge to balance these opposing forces. His leadership style is predictable: he tends to stay above the fray and allow competing factions in the FA to debate an issue to exhaustion and then weighs in with a final decision. Vazquez' adroit and pragmatic leadership along with Uruguay's strong institutions and the basically conservative nature of its society prevented the radical tilt some observers predicted during the 2004 electoral campaign. The contradictions between the radicals and moderates will probably have to be resolved if the FA is to win the 2009 national elections, since in the last elections the FA won only 50.1 percent of the vote.

Domestic Politics

¶10. (C) On March 1, Vazquez and his coalition Frente Amplio (FA) Government will have been in power for two years and have generally received high marks from the public, according to polling data. The moderates in his cabinet, especially Econ Minister Danilo Astori and Energy Minister Jorge Lepora, have generally enjoyed high approval and therefore exercise

considerable sway in foreign policy and the economy. The radicals within his FA coalition have challenged Vazquez much more than the two discredited opposition parties (Blancos and Colorados) who ruled the country during the past century. In his efforts to be practical, Vazquez relies on a relatively small cadre of experienced officials to get things done. A key ally in domestic politics has been Agriculture Minister and ex-Tupamaro guerrilla leader Jose Mujica who, despite his violent past, has often countered the extreme ideologues on the far-left. Vazquez was also able to appease many of the far-left radicals when he addressed the human rights abuses committed during the "dirty war" period of the military dictatorship, uncovered the buried bones of disappeared persons, and prosecuted some of the perceived worst human rights abusers.

Foreign Policy

¶11. (C) The country's foreign relations have historically reflected the efforts of a small nation to advocate self-determination, respect for human rights and the rule of law, the pacific settlement of disputes, and economic cooperation. For example, Uruguay's robust participation in international peacekeeping operations can be partly explained by its dedication to and faith in international organizations. However, foreign policy under the Vazquez administration has been a formidable challenge, compounded by the stubbornly ideological, anti-US Foreign Minister Reinaldo Gargano.

¶12. (C) By far, the GOU's most serious problem has been the severe bilateral dispute with Argentina over the construction of a Finnish-owned paper mill on a shared river -- not only because of soured bilateral relations with Uruguay's closest neighbor, but also because of the implications to foreign investment, an independent foreign policy, the power of radical NGOs and relations with Mercosur. At \$1.2 billion, the plant's construction cost represents 8% of Uruguay's GDP

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and its operation is expected to generate exports worth 2% of Uruguay's GDP. It represents the largest Foreign Direct Investment in Uruguay's history. Argentine government officials, some inhabitants of the Province of Entre-Rios across the river, and environmental activists claim the plant would harm fishing, farming, and tourist areas along the Uruguay-Argentina border. Argentina also claims that Uruguay violated the 1975 Uruguay River Treaty. Aspects of the case have gone before the International Court of Justice in The Hague and a Mercosur Tribunal, but Uruguay has sought little redress with the OAS. The U.S. voted to support the World Bank's IFC loan to the project. Protesters from Argentina have blocked bridges between Argentina and Uruguay off and on since December 2005 at great cost to Uruguay's trade and tourism revenues. The Uruguayans have felt bullied by Argentina's treatment and disappointed by Brazil's indifference. The paper mill dispute has indirectly contributed to closer ties with the U.S.

¶13. (C) Uruguay has a heavy debt burden and no known hydrocarbon deposits, so that Venezuelan oil and money provide considerable temptation to boost the economy. Uruguay's state oil monopoly ANCAP recently signed a deal with Venezuela's state-owned PDVSA to help fund 24 percent of the cost of oil exploration in the Orinoco region of Venezuela in return for a proportional share of the resulting oil. Details of the agreement remain murky, and observers are skeptical if ANCAP can fund its end of the bargain or if the endeavor will result in significant gains for Uruguay. As for PDVSA's pledge, a year and a half ago, to fund a \$600 million refurbishing of Uruguay's refinery to allow it to process Venezuela's heavy oil, it still remains to be implemented. There is also much interest in natural gas from Bolivia, but delivery through the existing pipelines would necessarily have to pass through Argentina, and thus be

subject to the vagaries of Argentine power needs.

The Economy, Trade and Investment

¶14. (U) Uruguay is a major agricultural producer. Agriculture and agro-industry account for 23% of GDP and over 75% of total exports. The major Uruguayan exports are meat (over \$1 billion this year), long-grain rice, dairy products, wool and soybeans. Forestry has surged over the last decade, due to favorable investment conditions and a favorable climate, where eucalyptus grows almost ten times as fast as in the U.S. Uruguay does not import agricultural products but does import processed foodstuff. Uruguay applies a 6.6% average tariff on agricultural goods and does not impose any kind of import quota. There are no subsidies to agricultural production or exports. Given the importance of this sector for the economy, Uruguay has been active in bilateral and multilateral fora to push for trade liberalization, and U.S. agricultural subsidies are a hot topic. The GOU's trade policy on agriculture has generally been in line with Mercosur's policies, and Uruguay is a member of the G-20 group of countries calling for the elimination of agricultural subsidies. The GOU threatened last year to file a case with the WTO on U.S. rice subsidies, but Embassy intervention allowed for the opening of a bilateral dialogue instead, in an attempt to resolve the issue. Talks are ongoing, but the threat of an impending WTO case still remains on the horizon.

Comment: A Valuable Friend Worth Cultivating

¶15. (C) Uruguay is unlikely to become a strategic partner of the U.S., but it can be a valuable friend in a region that has significantly distanced itself from us in many instances. Over the last two years, we have been able to build a remarkable level of confidence with President Vazquez through enhanced trade initiatives and other confidence-building measures. Now is the time to clearly define where we want our trade dialogue to lead us and if an FTA is our shared ultimate goal. Two ex-Presidents of Uruguay recently asked

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that I ensure that POTUS specifically engage Vazquez in discussing the path to an FTA. Another one advised against doing so in public. In any case, now is also the time to engage Uruguay beyond trade to other areas of bilateral cooperation, especially regional stability and security. I believe that this can be done, but it will take time. Meanwhile, the POTUS visit serves as an important building block for deepening our overall engagement with Uruguay. End Comment.
Baxter